ASG Analysis: Saudi Arabia Signals Major Policy Changes with New Draft Investment Law

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Key takeaways

- On April 4, Saudi Arabia's Ministry of Investment (MISA) published a new draft investment law for public consultation. The consultation period ends **May 5**, meaning that companies have two weeks remaining to submit their feedback.

- Although the draft law can and likely will evolve over the coming months, and most details will be left to the implementing regulations, the law as currently drafted would represent a major shift in Saudi investment policy clearly aimed at making the Kingdom more attractive to foreign direct investment.

- Most notably, the draft law alludes to the introduction of investment incentives that would be issued by sector regulators and approved by a ministerial committee, although it offers no information on the nature of these incentives or the qualification criteria.

- The draft law also codifies investor rights that were previously implied (including equal treatment of foreign vs. local investors); opens the door to alternative dispute resolution and international arbitration agreements; and is silent on the requirement for foreign investors to obtain a license from MISA except for investments in restricted sectors. We explore these and other important changes in more detail below.

- Given the sweeping potential implications of the law for the Saudi investment climate, we encourage companies doing business in the Kingdom to carefully prepare feedback to submit through the formal consultation process. MISA will look favorably on responses delivered in a clear, legalistic, and well-structured manner.

Key changes

Broadly speaking, the draft law relaxes prior restraints on investment, strengthens investor rights and protections, streamlines regulatory requirements, and gives government authorities greater flexibility to negotiate with investors. Below are some of the most important themes and provisions of the draft law.

- **Definition of direct investment**. Article 1 of the draft law defines direct investment broadly as the *"establishment of or acquisition of all or part of an economic enterprise providing products or services from within the Kingdom"* and lists a number of different types of direct investment relationships. Notably, unlike the standard definition of direct investment, this definition does not require that the investor hold a controlling stake in the investment. Under this definition, any ownership stake, no matter how small, would seem to qualify as direct investment. The exception is publicly traded equity for which the law requires a “lasting interest” (defined as at least a 10 percent stake or 30 percent board influence). Defining direct investment so broadly could help MISA reach its ambitious investment targets by including investment types that did not previously qualify as direct investment.

- **Investor rights.** Article 4 of the draft investment law codifies several important investor rights and protections, including the principle of equal treatment for foreign vs. domestic and private vs. public investors, the right to “impartial and non-discriminatory treatment,” the ability to transfer funds in and out of the Kingdom, protections for intellectual property and confidential business information, and recourse to competent courts or arbitration centers in the Kingdom. Article 4 also mentions personal data protection, likely a reference to the new Saudi Personal Data Protection Law (PDPL) which the Kingdom recently announced it would delay implementing by a full year (see our recent analysis). While many of these rights were previously implied in Saudi law, their explicit codification in the draft investment law suggests an effort by the Saudi government to offer foreign investors an additional degree of reassurance.

  However, cutting against this message, Article 4 ends with a broad caveat: *“The mere fact that action is taken (or an expected action is not taken) that may be inconsistent with an Investor’s expectations does not constitute a breach of this Article, even in cases which result in loss or damage to the interests of the Investor.”* This may be merely an attempt by MISA to protect itself against frivolous lawsuits, but it could also weaken the investor rights and protections outlined above.

- **Investor obligations.** Article 5 of the draft law outlines the obligations of investors. Most of these obligations – such as keeping records, meeting national corporate governance standards, paying taxes and dues, maintaining environmental and social standards, and abiding by labor, health, and safety laws – are unsurprising. However, one obligation stands out as potentially concerning for some foreign investors. The law requires that *“to the extent required by the Regulation, [investors] carry out business through an Establishment inside the Kingdom.”* This would appear to mean that, no matter the size of their investment, foreign investors will be required to establish a local legal entity in the Kingdom, which may not be a workable requirement in practice.

- **Investment incentives.** Article 6 of the new investment law indicates that “competent authorities” will have authority to negotiate directly with companies in issuing investment incentives, or “investment enablers.” Various authorities tasked with attracting investment to the Kingdom, such as the Saudi Industrial Development Fund, have long had authority to issue certain narrow kinds of incentives, mainly interest-free loans. The draft investment law appears to be aimed at expanding the incentive toolkit available to these authorities. All incentives will be subject to the approval of the Standing Ministerial Committee for Examination of Foreign Investments. For now, the draft law offers no information on the types of incentives that will be available and says only that incentives will be issued according to *“clear, objective, and non-discriminatory eligibility and evaluation criteria.”* These details will likely be left to the implementing regulations.

- **Registration requirements.** Article 7 of the draft law is notably silent on the longstanding requirement for foreign investors to obtain a license from MISA, except for investments in restricted sectors. Under existing Saudi investment law, foreign investors must obtain authorization from MISA to establish or acquire economic projects in the Kingdom. Under the new law, foreign investors would only need to inform MISA before any change in ownership of their investment. Under Articles 8 and 9, prior authorization requirements would be limited to a list of restricted sectors published by MISA. A wide range of activities used to be off limits to foreign investors, but that list has steadily shrunk in recent years as the Kingdom has opened its economy to foreign investment.

- **Dispute resolution.** Article 10 of the draft law would for the first time allow investors the right of recourse to alternative dispute resolution. It would also allow foreign investors to enter into international arbitration agreements, provided that their Saudi counterparties agree and that they obtain approval from the competent authority "*in accordance with the laws and regulations in force in the Kingdom*." This would address a longstanding point of concern for many foreign investors in the Kingdom. While the Saudi arbitration landscape has changed significantly in recent years with the adoption of a new arbitration law and the establishment of the Saudi Center for Commercial Arbitration, some concerns about the independence of the Saudi courts remain and many investors prefer international arbitration.

- **Priority sectors and special economic zones.** Finally, Article 14 of the draft investment law states clearly that nothing in the law would override or amend laws and regulations applying to "specific sectors of the economy" (though it does not specify what these sectors are), capital markets, or special economic zones (SEZs). The draft law will serve only to set a minimum standard for the rights and privileges of all investors in the Kingdom. The Kingdom is currently in the process of creating a number of SEZs to help attract investment in high-priority sectors, especially manufacturing and exports. The SEZ regulatory framework, which we expect to be issued in the coming months, may include long-term tax holidays and the waiving of restrictions on foreign ownership and capital repatriation.

Broader context

The draft investment law should be viewed in the context of broader developments in the Saudi investment landscape. Ahead of the annual Future Investment Initiative (FII) conference last October, the Kingdom unveiled its new National Investment Strategy (NIS) which sets highly ambitious targets for direct investment and the growth of the private sector. The NIS aims to increase private sector contribution to GDP to 65 percent, increase non-oil exports as a share of GDP from 16 to 50 percent, increase the investment-to-GDP ratio from 22 to 30 percent, and make the Kingdom one of the 15 largest economies in the world – all by 2030. To achieve these goals, the NIS calls for increasing annual foreign direct investment to SAR 388 billion (~$100 billion) and annual domestic investment to SAR 1.7 trillion (more than $450 billion) by 2030. The introduction of a new investment law designed to make the Kingdom more attractive to foreign investors is a natural next step in implementing the NIS.

Another key development in the Saudi investment agenda is the Regional Headquarters (RHQ) program launched by MISA last year, which plans to offer a variety of incentives to encourage multinational companies to establish their regional headquarters in the Kingdom (see our previous analysis). The launch of the RHQ program followed the February 2021 announcement that starting in 2024 companies with regional headquarters outside the Kingdom will no longer be eligible for government contracts. While there is still a great deal of uncertainty about the Saudi RHQ push – including with regard to how the Kingdom will implement the RHQ policy, what changes companies will need to make to their regional corporate footprints to comply, and exactly what incentives will be available – the program underscores the seriousness of Saudi ambitions to become a regional business hub.

Companies should also bear in mind the distinction between these broader efforts to attract foreign investment and big-ticket investment projects which will continue to be agreed on a case-by-case basis with significant involvement and support from senior Saudi leadership. The Supreme National Investment Committee, established last year to oversee the NIS and chaired by Crown Prince Mohammed bin Salman, is focused on coordinating government efforts to negotiate major investment deals. For example, California electric vehicle-maker Lucid Group (which is majority-owned by the Saudi Public Investment Fund) signed a deal last month to build its first international manufacturing plant in the King Abdullah Economic City outside Jeddah. This is just one example of a high-profile deal that received special support from the Saudi government, with several others in the pipeline.

Considerations for companies

- **The clock is ticking.** Given that only two weeks remain before the consultation window closes, companies wishing to take part in the public consultation process should begin preparing their responses if they have not done so already. In their responses, companies should acknowledge the important ways that the draft law improves the Saudi investment landscape, echo the goals of the Saudi investment agenda, emphasize their desire to invest in the Kingdom, and be specific in their asks rather than push for broad changes. MISA will look favorably on responses delivered in a clear, legalistic, and well-structured manner.

- **Plan for ongoing engagement**. The public consultation deadline is just the first hurdle. Companies should develop a plan for ongoing engagement with MISA and other relevant Saudi stakeholders over the coming months – both to inform policymakers as they finalize the investment law and, more importantly, to be in a position to advise on the development of the subsequent implementing regulations. In addition to MISA, companies should engage with relevant sector regulators and ministries which may have authority under the new law to issue their own incentives, especially for high-priority industries.

- **Develop a long-term strategy.** The rapid pace of changes in the Saudi investment landscape, from the new draft investment law to the RHQ program to the expected release of the SEZ legislation, makes it all the more important for companies to develop a long-term strategy for their presence and investment in the Kingdom. Companies should not enter negotiations with Saudi government stakeholders on the incentives question, the RHQ issue, or any other topic without first developing a very clear plan of what they want to achieve. New policies and government initiatives, some of which have conflicting goals, can offer multiple points of leverage for foreign investors in the Kingdom but also multiple tripwires for companies that do not have a clear strategy. An effective strategy will need to consider the full range of policy trends in the Kingdom and weigh the benefits of potential investment incentives and enablers against the costs of increasingly strict Saudization requirements, tax enforcement, and other challenges.

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